



County of Los Angeles CHIEF EXECUTIVE OFFICE

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WILLIAM T FUJIOKA
Chief Executive Officer

November 19, 2009

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To: Supervisor Don Knabe, Chairman
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From: William T Fujioka
Chief Executive Officer

A handwritten signature in black ink, appearing to read "W. T. Fujioka", is written over the printed name and title.

SACRAMENTO UPDATE

This memorandum contains a report on the Legislative Analyst's Office California Fiscal Outlook.

Legislative Analyst's Office Fiscal Outlook for California

On November 18, 2009, the Legislative Analyst's Office (LAO) released the California Fiscal Outlook for the Fiscal Years 2010-2011 through 2014-2015. In the outlook, the LAO projects a \$20.7 billion State Budget deficit through June 30, 2011. This includes an estimated shortfall of \$6.3 billion for FY 2009-10 (this Fiscal Year) and \$14.4 billion for FY 2010-11 (next Fiscal Year). The LAO projects ongoing State Budget deficits of approximately \$20.0 billion each year through FY 2014-15 with an estimated deficit of \$23 billion in FY 2012-13, the year in which the State must pay back the loan to local governments for Proposition 1A borrowing.

The LAO notes that the scale of the deficit is so vast that there is no way the Legislature, the Governor and voters can avoid making additional, very difficult choices about State priorities. The strings attached to Federal stimulus funding will result in much less spending flexibility in FY 2010-11. The LAO believes that major State spending programs will have to be significantly reduced, and that policy makers will need to add revenues to the mix of budget deficit solutions.

FY 2009-10 State Budget Deficit

The LAO projects that the State faces an estimated shortfall of \$6.3 billion in the current budget year. The deficit is attributable largely to the inability to achieve savings through the solutions enacted in the FY 2009-10 Revised State Budget. This

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includes: 1) \$1.4 billion in higher than projected spending by the California Department of Corrections and Rehabilitation for services provided by the Prison Care Medical Receiver and insufficient policy adjustments to allow prison and parole systems to meet budget reduction targets; 2) \$1.0 billion increase in the Proposition 98 minimum school funding guarantee; 3) \$800 million higher than projected spending for Medi-Cal due to the State's inability to obtain additional Federal funds or approval to implement administrative changes to increase flexibility and reduce program costs; 4) \$800 million in higher spending due to loss of a court case which limits the State's ability to use "spillover" gasoline sales tax and Public Transportation Account funds to reduce State General Fund expenditures; 5) failure to achieve \$1.0 billion in revenue from the sale of the State Compensation Insurance Fund; and 6) approximately \$1.3 billion in lower tax revenues.

Forecast for FY 2010-11

At the time the FY 2009-10 Revised State Budget was enacted in July 2009, the California Department of Finance projected a shortfall of \$7.4 billion for FY 2010-11. The expected shortfall was due in large part to a number of one-time and temporary budget solutions used to balance State expenditures and revenues, including the use of Federal stimulus funds, shifting funds from local governments to the State, and revenue accelerations. The LAO indicates that the Administration's shortfall estimate did not carry forward \$3.0 billion in lower tax revenues. In addition, the continuing spending trends for FY 2009-10 described above will result in a total projected budget shortfall of \$14.4 billion for FY 2010-11.

Additional Risks, Uncertainties and Cost Pressures

The LAO indicates that the forecast captures the best estimates available regarding the State's fiscal condition; **however, the State faces an unusually high number of other risks, uncertainties, and cost pressures not accounted for in the forecast.** The State's tax system is volatile and can respond negatively to bad economic trends and very positively in favorable economic trends. This makes it very difficult for the LAO to estimate when and how quickly the State will recover from the current economic downturn. The forecast assumes that the State will increase expenditures to make up for the loss of temporary Federal stimulus funds for health, social services, higher education, and prison programs. However, the Legislature will need to determine whether to increase State funding even more to make up for the loss of temporary Federal stimulus funding for school districts. **In addition, the State faces numerous lawsuits related to prior budgetary actions. Should the courts rule against the State, the budget shortfall could increase by millions or billions of dollars.**

Two major Federal issues could significantly impact the State Budget in the future. Federal health care reform could expand the Medicaid program, change

Each Supervisor
November 19, 2009
Page 3

reimbursements to providers and affect State employee benefits. **The State's current Medicaid hospital waiver expires in August 2010. Due to uncertainties regarding these two issues, the LAO was unable to include potential fiscal impacts in the forecast.**

Keys to Balancing the Budget

The LAO notes that the Legislature enacted a variety of solutions to close the \$60.0 billion budget gap in FY 2008-09 and FY 2009-10. The LAO acknowledges that because the Legislature has already made many difficult decisions, it may be even more difficult to address the immediate \$20.7 billion shortfall which includes the projected shortfalls of \$6.3 billion in FY 2009-10 and \$14.4 billion FY 2010-11. The LAO recommends that the Legislature consider the following strategies to bring the budget into balance: 1) take action within the next few months to achieve a full year's worth of savings in FY 2010-11; 2) focus on long-term solutions; 3) set priorities in making the reductions to all major State programs; 4) consider revenue options including fee increases for programs currently supported by State General Funds, and extending temporary tax increases enacted in February 2009 which are set to expire on June 30, 2011; 5) aggressively seek new Federal assistance including an extension of Federal stimulus funds for the Temporary Assistance for Needy Families Emergency Contingency Fund and the increase in the Federal Medicaid Assistance Percentage; and 6) use the Statewide elections scheduled in June 2010 and November 2010 to present funding options to the voters including redirecting funds from First 5 California, after school programs, and Proposition 63, the Mental Health Services Act.

Potential County Impact

In FY 2008-09, the County lost an estimated \$150.1 million and in FY 2009-10 the County lost an estimated \$276.4 million, for a total two-year loss of \$426.5 million due to State Budget deficits. The ongoing shortfall continues to place the County at significant risk of additional funding cuts. The Governor will release his proposed FY 2010-11 by January 10, 2010. There is a lot of speculation that the Governor will convene a Special Session of the Legislature before January 10 to address the current year \$6.3 billion shortfall and the estimated \$14.4 billion funding gap in FY 2010-11.

We will continue to keep you apprised.

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c: All Department Heads
Legislative Strategist